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BY ELECTRONIC MAIL

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Paul M. Wester, Jr.
Director
Modern Records Program
National Archives and Records Administration
8601 Adelphi Road
College Park, MD 20740

David Kotz
Inspector General
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2736

Re: How did the SEC Violate 44 U.S.C. § 3314?

Dear Messrs. Wester and Kotz:

The undersigned represents Darcy Flynn, whose whistleblower claims to the Securities and Exchange Commission (SEC) Chairman Mary Schapiro, the SEC's Inspector General, and Congress were the subject of a NARA press release yesterday. It appears that NARA has concluded (1) the SEC has destroyed records in violation of the Federal Records Act (44 U.S.C. § 3314 and 36 C.F.R. § 1220.18) and (2) the "SEC has been slow in creating records schedules for review and approval by the Archivist of the United States that will ultimately determine how long these MUI records need to be retained."

As Mr. Flynn has taken some personal risks in stepping forward, he is gratified that NARA has taken his allegations seriously and is acting expeditiously. Still, based on the public statements by the SEC and NARA yesterday, we have some concern that NARA may not be getting an accurate picture of the context in which SEC officials destroyed files containing federal records for approximately 9,000 matters under inquiry (MUIs). So that NARA may have a more complete record on which to act, the undersigned, on behalf of Mr. Flynn, proposes a meeting with Mr. Flynn, a representative of NARA, a representative of the OIG and the undersigned to further discuss the facts presented below.

In this light, we would invite NARA to dig a little deeper into the issue whether the SEC and its senior officials violated 44 U.S.C. § 3314 by destroying 9,000 sets of files (1) because they failed to obtain a disposition schedule or (2) because they violated an existing disposition schedule. This is not a distinction without a difference. Either violation is serious and could subject the violator to criminal sanctions. Further, the manner in which the statute was violated may point to the responsibility of different officials within the SEC. It is therefore even more important that NARA carefully parse the facts to determine exactly how the SEC decided to

destroy thousands of files containing federal records. Otherwise, there can be no accountability. And the absence of accountability invites an encore.

For these reasons, we must question your conclusion that no schedule exists for "matters under inquiry" or MUIs, though we understand how you might have reached that conclusion. A check of the Enforcement Division's current schedule reveals no reference to "matters under inquiry" or to MUIs, and thus it would seem to follow that MUIs are not scheduled.

But this simple analysis overlooks one key fact that is not so obvious. "MUI" is simply one of three labels the SEC uses to refer to "preliminary investigations," which are explicitly covered by the Division of Enforcement's retention schedule approved by NARA on December 9, 1992.[1] It specifies a minimum 25-year retention period for "Investigative Case Files... including case files relating to preliminary investigations."

The SEC's use of the term MUI as a pseudonym for "preliminary investigation" may also explain why the SEC Enforcement Division did not submit a schedule for MUIs over the past 17 years. It already has one on file covering the same investigatory phase: why would it need two?

The three phrases—preliminary investigation, matters under inquiry, and informal investigation—all refer to the same investigative process, but only one of terms—preliminary investigation—has ever been recognized in the rules authorizing and delimiting the Enforcement Division's powers and operations. From 1960 to the present, the term "preliminary investigation," as it pertains to the SEC, has been defined by Rule 202.5(a)[2] of Title 17 of the U.S. Code of Federal Regulations. Rule 202.5 describes two types of investigations: preliminary investigations and formal investigations. The essential difference between the two types of investigations boils down to five words: the power to issue subpoenas. Enforcement staff may issue a subpoena during a formal investigation, but may not do so during a preliminary investigation.

The term "matter under inquiry" is nowhere to be found in Title 17 of the Code of Federal Regulations. Put differently, if the SEC has created a new process and then forgot to tell NARA about it for the last 17 years, it also failed to seek authority to conduct this new process under the Code of Federal Regulations.

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[1] Available at: http://www.archives.gov/records-mgmt/rcs/schedules/independent-agencies/rg-0266/n1-266-91-002_sf115.pdf.

[2] Rule 17 CFR § 202.5(a) reads:

> Where, from complaints received from members of the public, communications from Federal or State agencies, examination of filings made with the Commission, or otherwise, it appears that there may be violation of the acts administered by the Commission or the rules or regulations thereunder, a preliminary investigation is generally made. In such preliminary investigation no process is issued or testimony compelled. The Commission may, in its discretion, make such formal investigations and authorize the use of process as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of the federal securities laws or the rules of a self-regulatory organization of which the person is a member or participant. Unless otherwise ordered by the Commission, the investigation or examination is non-public and the reports thereon are for staff and Commission use only.

Going a step further, if a MUI is the process that takes place before a formal order, as it is explained in the SEC's Enforcement Manual,[3] what then is the process referred to as "preliminary investigation" as mentioned in Rule 202.5, throughout the SEC website,[4] and federal case law involving the SEC[5]? Does the SEC Enforcement Division conduct three different types of fact inquiries: MUIs, preliminary investigations, and formal investigations?

At an international securities conference sponsored by the SEC in 2005, Deputy Enforcement Director Linda Thomsen used the terms "informal" or "preliminary" investigation interchangeably and then explained how both terms described the same process:

> Commission investigations usually begin as "informal" or "preliminary" investigations. In an informal investigation, the Commission staff does not have power to compel testimony or the production of documents by subpoena. Rather, the staff relies on the cooperation of individuals and entities from which information is sought. … Entire investigations can often be done on an informal basis. Many individuals and entities voluntarily produce documents and provide testimony. …
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> In addition, certain procedural safeguards that apply to a formal investigation also apply to informal investigations. Interviews with witnesses are typically conducted with a court reporter present and a verbatim transcript is usually produced. Although the staff cannot administer oaths or affirmations in a preliminary investigation, if a witness is willing to testify on the record, the Staff, after obtaining the witnesses's consent, will have the court reporter administer an oath. A criminal statute, which prohibits the making of false statements to government officials, 18 U.S.C. § 1001, applies even if the witness is not under oath. If the witness is placed under oath, then false testimony may be subject to punishment under federal perjury laws as well.
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> A preliminary investigation can conclude with or without a staff recommendation that the Commission authorize a formal investigation or an enforcement proceeding. Although cooperation by the persons and entities from which

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[3] Securities and Exchange Commission, Division of Enforcement, Office of Chief Counsel, *Enforcement Manual*, Aug. 2, 2011. Available at: http://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

[4] See for example: Testimony of Linda C. Thomsen, *Director, Division Of Enforcement,* Before the U.S. Senate Committee on Banking, Housing and Urban Affairs ("Senate Banking Committee"), Jan. 27, 2009 (The SEC's Office of Market Surveillance automatically opens a preliminary investigation of each such referral and then forwards it to appropriate staff, generally based on geographic location of the issuer or suspected traders), available at http://www.sec.gov/news/testimony/2009/ts112709lct.htm; see Rule 230 of the SEC Rules of Practice ("*Each request for documents, testimony or other information from persons not employed by the Commission specifies the investigation or preliminary investigation number to which it relates"), available at* http://www.sec.gov/about/rulesprac072003.htm; Testimony of Julie Preuitt, SEC Fort Worth Regional Office, before the Senate Banking Committee, May 30, 2011 ("In May 1998, after receiving an inquiry from another agency regarding Stanford's activities, enforcement decided to open a preliminary investigation."), available at http://www.sec.gov/news/testimony/2011/ts051311jp.htm.

[5] See for example: *SEC v. Wheeling-Pittsburgh Steel Corp.*, 648 F.2d 118, 126-127 (3d Cir. 1981) ("A preliminary investigation, in which no process is issued or testimony compelled, is proper whenever 'it appears that there may be (a) violation'"), and *SEC v. Gemstar-TV Guide Int'l, Inc.,* 401 F.3d 1031 (9th Cir. Cal. 2005) (Citing, "*Am. Jur. Securities, Regulation-Federal* § 1622 (noting that in most circumstances 'neither a Commission decision whether to conduct a preliminary investigation nor a formal order of investigation is a final order which may be judicially reviewed"').

> information is sought may keep an investigation informal, non-cooperation by third party witnesses, or the need to obtain information from entities that require a subpoena, such as banks and telephone companies, often necessitates that the staff seek Commission authorization to conduct a formal investigation.[6]

Four years later in 2009, then Enforcement Director Thomsen used much the same language to describe a "preliminary" investigation.[7]

The courts use similar language to describe a "matter under inquiry" as Director Thomsen used to describe a preliminary investigation. In *Feshbach v. SEC,* 5 F. Supp. 2d 774, 783 (N.D. Cal. 1997), the court, citing the testimony of an SEC official (Goins), described a "matter under inquiry" in the same way that Deputy Director Thomsen described a "formal" or "preliminary" investigation:

> There are two types of investigations. Goins Dep. at 26. There is a Matter Under Inquiry ("MUI"), which is conducted by Commission staff. Id. If the staff believes there may have been violations of federal securities laws, the staff seeks authority from the Commission to conduct an investigation pursuant to a formal order of investigation.

Likewise, the SEC's Enforcement manual describes MUIs[8] with much the same properties as Director Thomsen and Rule 202.5 describe preliminary investigations. The Enforcement Manual likewise distinguishes MUIs from formal investigations in much the same way as Director Thomsen and Rule 202.5 distinguish preliminary investigations from formal investigations.[9] Finally, the media has followed suit by explaining that the SEC's use of the term "matter under inquiry" means the same thing as a "preliminary investigation."[10]

The SEC's Fiscal 2007 Congressional Budget Request, the latest one available on the SEC's website, also demonstrates the SEC's interchangeable use of the term "MUI" for

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[6] Linda C. Thomsen, International Institute for Securities Market Development, 2005 Program, at pp. 2 and 3. Available at http://www.sec.gov/about/offices/oia/oia_enforce/overviewenfor.pdf.

[7] Testimony of Enforcement Director Linda Thomsen Concerning Investigations and Examinations by the Securities and Exchange Commission and Issues Raised by the Bernard L. Madoff Investment Securities Matter, Jan. 27, 2009:

> The SEC's Office of Market Surveillance automatically opens a preliminary investigation of each such referral and then forwards it to appropriate staff, generally based on geographic location of the issuer or suspected traders. The staff then becomes responsible for further inquiries that will either lead to the opening of a full investigation or the closure of the preliminary investigation.

Available at: http://www.sec.gov/news/testimony/2009/ts112709lct.htm.

[8] Securities and Exchange Commission, Division of Enforcement, Office of Chief Counsel, *Enforcement Manual*, Aug. 2, 2011, at p. 17. Available at: http://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

[9] *Id.* at 20.

[10] Marie Leone, Bush *Puts SEC Budget on a Diet,* CFO.com, Feb. 6, 2007:

> The 2007 budget amount will remain relatively flat, but will jump to $321 million in 2008 to account for salary increases. The SEC predicts it will handle 2 million investor complaints, tips, and forwarded investor-related spam e-mail messages in 2008. In addition, the division believes it will open about 1,300 new matters under inquiry—which are considered preliminary investigations—and begin 925 more formal investigations.

"preliminary investigation." The Budget Request noted that "staff expects to receive and handle a combined total of 675,000 investor complaints, tips, and forwarded e-mail spams and to open about 1,430 new matters under inquiry (MUIs)…The staff plans to open roughly 960 investigations."[11] Once again, the SEC has obviously used the term "matters under inquiry" to refer to preliminary investigations.

In short, there is overwhelming evidence that MUIs and preliminary investigations refer to the same investigative process. This raises the issue: Can the SEC ignore its schedule with NARA because it sometimes uses a different name to refer to a scheduled class of records? Putting form over substance in this way would allow any agency to bypass the Federal Records Act at its whim. We respectfully submit that Congress could not have intended the Federal Records Act to be so easily ignored.

The real issue that NARA should be investigating is who at the SEC came up with the idea of attributing a new name to a preliminary investigation and then using that device to destroy thousands of files of preliminary investigations. We respectfully submit this would be an appropriate focus of your inquiry into the destruction of the records in question.

In this light, we should also point out that the preservation of records does not appear to be one of the SEC's strengths. An OIG report in 2009 tells how the SEC ignores its obligations under FOIA. In general, the report observes "in all FOIA request disposition categories, the Commission's overall rate was significantly lower when compared to all other federal agencies."[12] "Significantly lower" is generous: A table in the report compares the SEC's "full grants" (10.5%) and "partial grants" (2.9%) of FOIA requests with those of all other Federal agencies' full grants (41.8%) and partial grants (18.7%). In short, the SEC releases records 13% of the time versus 60% for all other agencies. The report concludes the SEC has replaced the presumption of disclosure under FOIA with a "Presumption of Non-Disclosure" and cites the SEC's abuse of Exemption 7(A) as a device for doing so.[13]

Sincerely,

Gary J. Aguirre

cc: Senator Chuck E. Grassley

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[11] SEC Fiscal 2007 Congressional Budget Request , available at http://www.sec.gov/about/secfy07budgetreq.pdf.

[12] *Review of the SEC's Compliance with the Freedom of Information Act*, Report No. 465, Sep. 25, 2009, at 9. Available at http://www.sec-oig.gov/Reports/AuditsInspections/ oig.gov/Reports/Audits Inspections/2009/465.pdf#xml=http://www.sec-oig.gov/Search/PdfHighlighter.aspx?DocId=30&Index= D%3a%5c Websites%5cUseIndex%5cSEC&HitCount=12&hits=1+2+3+4+5+6+7+8+9+a+b+c+

[13] *Id.*